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TO ALL OECD CAPITALS

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C O R R E C T E D C O P Y (OMISSION LINE 5, PARA 4)

E.O. 11652: N/A

SUBJECT: MEETING OF EPC WORKING PARTY-3, JUNE 25-26

1. WP-3 IN WIDE-RANGING REVIEW OF INTERNATIONAL PAYMENTS SITUATION, EMPHASIZED ESSENTIALITY OF PROMPT ADJUSTMENT ACTION BY NUMBER OF OECD COUNTRIES TO ACHIEVE BETTER DISTRIBUTION OF CURRENT ACCOUNT DEFICITS, NOTED THAT SEVERAL COUNTRIES WERE TAKING SIGNIFICANT STEPS AND HEARD EXPRESSIONS OF CONFIDENCE THAT 1974 DEFICITS OF PARTICIPANTS COULD BE FINANCED WITHOUT SERIOUS DIFFICULTY. WHILE GROUP COULD NOT BE COMPLACENT, THERE WAS NO NEED FOR NERVOUSNESS, DISPLAY OF WHICH WOULD WEAKEN BARGAINING POSITIONS IN RELATION TO OIL PRODUCING STATES WHO WERE COMPELLED TO INVEST FUNDS WOMEWHERE.

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KEY TO ADJUSTMENT WOULD BE PROPER DEMAND MANAGEMENT IN

MEMBER COUNTRIES WITH EXCHANGE RATE CHANGES LIKELY BE INEFFECTIVE UNLESS ACCOMPANIED BY CORRECT DEMAND MANAGEMENT. ITALIANS CONFIDENT NW RESTRAINT PROGRAM WOULD, IN THREE TO FIVE MONTHS, BRING COMBINATION OF IMPROVEMENT IN CURRENT ACCOUNT POSITION AND CAPITAL FLOWS SUFFICIENT ENABLE THEM TO RESTORE BORROWING CAPABILITY. MEANTIME, COULD USE EXISTING FINANCIAL RESOURCES. FRENCH SAW THEIR STABILIZATION PROGRAM AS ADEQUATE TO PRESERVE BORROWING CAPACITY. BRITISH SAID HAD LOWERED INTEREST RATES TO AVOID CAPITAL INFLOW TENDING TO BE EXCESSIVE DESPITE VERY LARGE CURRENT ACCOUNT DEFICIT. END SUMMARY.

2. ITALIANS ESTIMATED THAT FISCAL MEASURES BEING PRESENTED TO PARLIAMENT WOULD, WITH THREE TO FIVE MONTH TIME LAG, DEPRESS IMPORT LEVEL AT RATE OF 500 MILLION LIRE FOR EVERY 1 BILLION LIRE OF NEW TAX (THUS ABOUT \$1 1/2 BILLION ANNUAL RATE). THEY HOPED EXPORTS WOULD GROW AS RESULT BUT MADE NO ALLOWANCE FOR SUCH GROWTH IN SUGGESTING THAT AS POSITION WAS SEEN TO BE IMPROVING IT WOULD BE REINFORCED BY END OF CAPITAL FLIGHT AND THAT ABILITY TO BORROW ABROAD WOULD REVIVE. HAD NO PLAN TO DROP IMPORT DEPOSIT SCHEME (DESIGNED AS CREDIT TIGHTENING MEASURE) WHICH ESTIMATED TO SAVE 200 TO 300 BILLION LIRE. ALTHOUGH CURRENT ACCOUNT DEFICIT MIGHT STILL BE \$5 1/2 BILLION IN NEXT 12 MONTHS (CHAIRMAN EMMINGER'S ESTIMATE) ITALIANS SAID MEANS WERE AVAILABLE TO MEET IT. LISTED FOREIGN EXCHANGE RESERVES, IMF AND SWAP ARRANGEMENTS. EXPECTED BE ABLE BORROW FROM MARKET ALSO.

3. BRITISH (MITCHELL) ACKNOWLEDGED PROSPECT OF 4 BILLION CURRENT ACCOUNT DEFICIT IN 1974 AND 2 BILLION IN 1975 BUT SAW NO FINANCING PROBLEMS. U.K. ARGUED THAT FURTHER REDUCTION IN CURRENT ACCOUNT DEFICIT WAS DEPENDENT ON ACTIONS OF OTHERS -- PRIMARILY ON RATES OF GROWTH IN U.S. AND GERMANY. U.K. ECONOMY IS FLAT, PRICES ARE BELIEVED COMPETITIVE; AND BRITISH CONTENT THERE IS SUFFICIENT CAPACITY TO MEET EXPORT DEMAND. INTEREST RATES ARE BEING GUIDED SO AS TO REDUCE AMOUNT OF CAPITAL INFLOW NEEDED TO FINANCE CURRENT DEFICIT AND LIMITED OFFICIAL USE

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MARGIN OVER INTERNATIONAL RATES RECENTLY REDUCED TO AVOID EXCESS INFLOW.

4. FRENCH EXPECT 1974 CURRENT ACCOUNT DEFICIT OF \$6 1/2 BILLION, FINANCED BY \$2 BILLION NET PRIVATE CAPITAL INFLOW AND COMPENSATORY BORROWING OF WHICH \$4 BILLION ALREADY ARRANGED OR IN PROCESS. SPOKESMAN (DEGUEN) REITERATED POLICY AIM OF BALANCE ON GOODS AND SERVICES

(WHICH SAID TO EXCLUDE \$1 BILLION DEFICIT ON INVESTMENT INCOME AND \$2 BILLION DEFICIT ON UNILATERAL TRANSFERS) BY END 1975. PLAN TO CUT DEFICIT (FROM 1974 LEVEL) \$3 1/2 BILLION VIS-A-VIS OIL PRODUCING STATES AND \$1 BILLION VIS-A-VIS OECD PARTNERS. DEGUEN ASSURED SOMEWHAT CONCERNED WP THAT FRANCE HAD NO INTENTION OF USING EITHER TRADE RESTRICTIONS OR UNDUE DEMAND RESTRAINT TO ACHIEVE TRAGET WHICH DELIBERATELY MADE AMBITIOUS TO IMPRESS FRENCH PUBLIC WITH SERIOUSNESS OF SITUATION. DEGUEN DID SUGGEST THAT FRENCH WOULD NOT USE RESERVES SINCE GOLD NOT USABLE AND DID NOT WISH WORKING CAPITAL TO BE DEPLETED.

5. JAPANESE (INAMURA) EXPECTED CURRENT ACCOUNT TO IMPROVE UNTIL FALL WITH FURTHER PROGRESS DEPENDENT ON "WORLD CONDITIONS." ACCEPTED SECRETARIAT ESTIMATE OF \$7 1/2 BILLION CURRENT ACCOUNT DEFICIT FOR 1974 BUT OFFERED NONE FOR 1975. ACKNOWLEDGED THAT IN 1974 TO DATE LARGE PART OF FINANCING PROVIDED BY ALLOWING REBUILDING OF SHORT-TERM IMPORT FINANCING WHICH HAD BEEN CUT BACK DURING EARLIER PERIOD OF RAPID RESERVE BUILD UP. NOTED THAT JAPAN COULD ALLOW EXTERNAL BORROWING BY NON-BANKING SECTOR WHEN MONETARY RESTRAINT NO LONGER REQUIRED BY DOMESTIC CONSIDERATIONS. THUS SAW NO FINANCING PROBLEM IN NEAR FUTURE.

6. CHAIRMAN CALLED ON USSING OF DENMARK (PRESENT AS MEMBER OF SWEDISH DEL) FOR STATEMENT OF PROBLEM OF SMALL DEFICIT COUNTRY. DANES EXPECT 1974 CURRENT ACCOUNT DEFICIT OF \$1.15 BILLION OF WHICH \$.9 WOULD BE IN FIRST HALF. EXPECTED HAVE NO FINANCING PROBLEMS IF CURRENT ACCOUNT IMPROVED AS EXPECTED IN RESPONSE TO SEVERE RESTRAINT MEASURES INCLUDING INCREASE IN LIMITED OFFICIAL USE

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INDIRECT TAXES WEIGHTED HEAVILY ON GOODS IMPORTED. EXTENSIVE WAGE INDEXING CREATING SEVERE DIFFICULTIES IN STOPPING PRICE RISE.

7. GERMANS (POEHL AND EMMINGER) INDICATED CURRENT ACCOUNT LIKELY SHOW \$6 TO 7 BILLION SURPLUS IN 1974 WITH TRADE SURPLUS IN RANGE OF \$20 BILLION. POEHL ACKNOWLEDGED THAT GNP GROWTH DUE ENTIRELY TO EXPORT SURPLUS BUT PROFESSED GERMANY HELPLESS TO REMEDY SITUATION CONSISTENT WITH BATTLE AGAINST INFLATION. NOTED THAT DM RATE WAS FLOATING BUT THAT CERTAIN MAJOR TRADING PARTNERS WERE INTERVENING TO PREVENT DEPRECIATION THEIR CURRENCIES THUS EFFECTIVELY PREVENTING APPRECIATION OF DM. FISCAL AND MONETARY RESTRAINTS HAD ALSO BEEN RELAXED TO EXTENT FEASIBLE WITHOUT

ALTERING PSYCHOLOGY. WP, INCLUDING GERMAN DEL, PERPLEXED BY TREND OF TRADE BALANCES, ALTHOUGH INCLINED TO BELIEVE TIME LAGS LARGELY RESPONSIBLE -- LAGS BOTH IN EXPANSION OF PRODUCTIVE CAPACITY ABROAD WHERE PRODUCTION MADE COMPETITIVE WITH GERMAN GOODS AS RESULT EXCHANGE RATE REALIGNMENT AND IN DELIVERY OF LONG-LEAD ITEMS ORDERED BY FOREIGNERS DURING PERIOD OF EXCESS DEMAND. GERMAN FORECASTS DID NOT TAKE ACCOUNT OF RECENT ITALIAN AND FRENCH DEMAND MEASURES.

8. DUTCH (KESSLER) ANTICIPATED \$.75 MILLION CURRENT ACCOUNT SURPLUS IN 1974 BUT QUESTIONED SECRETARIAT ESTIMATE OF \$1 1/2 BILLION ANNUAL RATE IN FIRST HALF 1975 ON GROUNDS THAT TIMING AND EXTENT OF PRICE INCREASES IN DUTCH EXPORTS OF NATURAL GAS UNCERTAIN. RISE IN DUTCH GNP ALSO DUE LARGELY TO EXTERNAL DEMAND AND GOVERNMENT EFFORTS INDUCE EXPANSION OF INVESTMENT AND THUS PRODUCTIVE CAPACITY NOT YET SUCCESSFUL. WITH EXISTING CAPACITY FULLY UTILIZED DUTCH FEEL UNABLE USE GENERAL MEASURES TO INDUCE EXPANSION.

9. IN RESPONSE TO FRENCH INQUIRIES U.S. (CROSS) DENIED PRESS REPORTS OF U.S. OFFER LARGE (\$8 TO \$10 BILLION) NONMARKETABLE TREASURY SECURITIES TO SAUDIS WITH GOLD GUARANTEE. EXPLAINED THAT NON-MARKETABLE SECURITIES HAD BEEN MADE AVAILABLE TO NUMBER OF MONETARY AUTHORITY LIMITED OFFICIAL USE

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TIES AT MARKET RATES AND THAT WOULD BE LOGICAL DEVISE SUCH SECURITIES FOR SAUDIS IF INTERESTED. CROSS DREW DISTINCTION, HOWEVER, BETWEEN MARKET YIELDS AND SPECIAL INCENTIVES. SAID U.S. NOT IN COMPETITION FOR FUNDS BUT POINTED OUT THAT TO EXTENT OIL PRODUCERS DID PURCHASE U.S. TREASURY SECURITIES, U.S. BORROWING FROM DOMESTIC RESIDENTS WOULD BE REDUCED AND PRIVATE SAVINGS THUS MADE AVAILABLE FOR LENDING ABROAD. USE OF DIFFERENT CHANNELS MIGHT FACILITATE RECYCLING, AT LEAST BY MINIMIZING CONCENTRATION OF BANK LIABILITIES TO FEW LENDERS. CROSS NOTED THAT HIGHER YIELDS OF SHORT-TERM INSTRUMENTS LIKELY MAJOR REASON FOR CONCENTRATION OF OIL PRODUCER MONEY IN SHORT-TERM MARKET INSTRUMENTS.

10. MITCHELL NOTED THAT OIL PRODUCERS COULD BE DRIVEN TO USE VARIETY OF CHANNELS AND MATURITIES BY SHEER VOLUME OF THEIR FUNDS IF BORROWERS MAINTAINED POSTURE OF COMPLACENCY AND DID NOT "ADVERTISE OUR NEED". OTHERS FELT THAT DESPITE FREQUENTLY HEARD WORRIES AND CONCERNS OF PRIVATE BANKERS SITUATION NOT TROUBLESOME AT THIS TIME ALTHOUGH SOME WORRIES ABOUT FUTURE WERE EXPRESSED. BIS REPRESENTATIVE (GILBERT) AND DOW (U.K.) DESCRIBED

NUMBER OF WAYS IN WHICH MARKET WAS ABLE TO ADAPT AND PROTECT ITSELF. LIFTING OF U.S. CAPITAL CONTROLS HAD MADE MARKET MORE RESILIENT. NEW CHANNELS APPEARED TO BE DEVELOPING WITH BANKS SERVING AS BROKERS FOR DIRECT PLACEMENTS. DIFFERENTIAL RATE STRUCTURE DEVELOPING BOTH FOR LENDERS AND BORROWERS. ALTHOUGH POSSIBILITY OF NEED FOR CENTRAL BANKS TO BE LENDER OF LAST RESORT WAS DISCUSSED, CONCLUSION APPEARED TO BE THAT PROBLEM WOULD HAVE TO BE DEALT WITH ON AD HOC BASIS.

11. CROSS ALSO REPORTED U.S. TRADE DEFICIT OF \$775 MILLION IN MAY AND PROSPECT OF QUITE SIZABLE TRADE DEFICITS IN MONTHS AHEAD.

12. MITCHELL URGED THAT NEW C-20 DEVELOPMENT COUNCIL BE HARRASSED TO GET FUNDS MOVING QUICKLY TO NON-OIL LDCS. SISCO

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